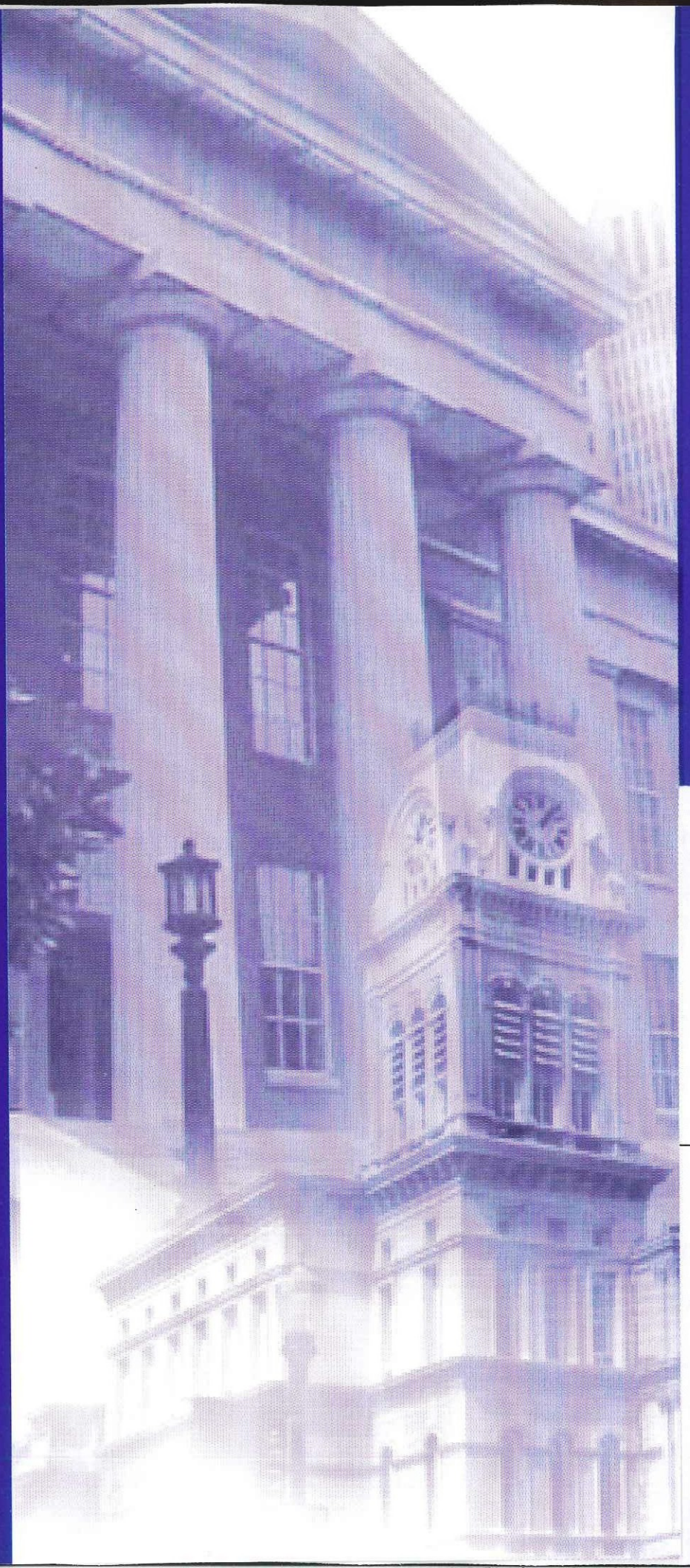




Greg Fischer  
Mayor

Louisville Metro Council

The Office of Internal  
Audit provides independent,  
objective assurance and  
consulting services  
that adds value to and  
improves Louisville  
Metro Government.



# Office of Internal Audit

Louisville Metro Government

Supplier Payment Threshold





# Audit Report

## Louisville Metro Government

### Supplier Payment Threshold

August 2013

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## Executive Summary

### PROJECT TITLE

#### Louisville Metro Government – Supplier Payment Threshold

### OBJECTIVE AND SCOPE

The objective was to obtain assurance that operational risks are adequately mitigated through the internal control structure. The primary focus was compliance with payment transaction threshold requirements, i.e., those transactions exceeding the limits were processed appropriately. This was a scheduled audit.

This was a compliance review based on project expenditures during the specified timeframe. Review covered activity from Fiscal Year 2012 (July 1, 2011 – June 30, 2012). The details of the scope and methodology of the review are addressed in the Observations and Recommendations section of this report.

### INTERNAL CONTROL ASSESSMENT

#### Needs Improvement

### RESULTS

Issues were noted with Louisville Metro Government's supplier payment activity. As a result, the effectiveness of the internal control structure is impaired and needs improvement. Examples of the issues include the following.

- **Threshold Compliance.** The LeAP financial system does not monitor the \$10,000 aggregate limit, but does monitor the \$2,500 invoice limit.
  - The payment activity for one of fifteen suppliers reviewed exceeded the \$10,000 aggregate limit.
  - All transactions reviewed for the \$2,500 invoice limit were in compliance with policy.
- **Contractual Compliance.** Issues were noted concerning the compliance with contractual documentation.
  - There were issues with the procurement of services related to the contractual agreement.
  - There were payment transactions which were not in compliance with the contracted price for goods/services.
  - There were payment transactions in which compliance with contractual terms for goods/services could not be determined due to lack of supporting documentation.



OFFICE OF INTERNAL AUDIT  
LOUISVILLE, KENTUCKY

GREG FISCHER  
MAYOR

INGRAM QUICK, CHIEF AUDIT EXECUTIVE

JIM KING  
PRESIDENT METRO COUNCIL

**Transmittal Letter**

August 2, 2013

The Honorable Greg Fischer  
Mayor of Louisville Metro  
Louisville Metro Hall  
Louisville, KY 40202

**Subject: Audit of Louisville Metro Government's Supplier Payment Thresholds**

**Introduction**

An audit of Louisville Metro Government's supplier payment thresholds was performed. The primary focus was compliance with payment transaction threshold requirements, i.e., that transactions exceeding the limits were processed appropriately. The basis for the requirements includes both statutory (e.g., Kentucky Revised Statutes) and internal policies and procedures. The objective was to obtain assurance that the risks were adequately mitigated through the internal controls process.

The audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

As a part of the review, the internal control structure was evaluated. The objective of internal control is to provide reasonable, but not absolute, assurance regarding the achievement of objectives in the following categories:

- Achievement of business objectives and goals
- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations
- Safeguarding of assets

There are inherent limitations in any system of internal control. Errors may result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personnel factors. Some controls may be circumvented by collusion. Similarly, management may circumvent control procedures by administrative oversight.

## Scope

Louisville Metro's purchasing policies and procedures were reviewed and interviews conducted with key personnel. The focus of the review was compliance with threshold requirements, i.e., that supplier payment transactions exceeding the limits were processed appropriately. Specific areas of compliance included the following:

- Aggregate payments to vendors exceeding \$10,000
- Individual invoices exceeding \$2,500
- Terms specified in authorizing documents (e.g., contract, grant, price quote)

Payments exceeding these thresholds should be authorized by a purchase order administered through the Office of Management and Budget and follow applicable purchasing policies and procedures according to the purchase type and method. For this review, the \$10,000 threshold was applied cumulatively, not on an individual department basis. The procedures for monitoring payment thresholds were also reviewed.

The review period covered supplier payment activity from July 1, 2011 through June 30, 2012. The population of payment transactions was obtained from Louisville Metro Government's LeAP financial system. Analytical reviews were performed to determine the number of suppliers paid, amounts paid, and the number of transactions. A sample of payment transactions was reviewed to determine whether transactions were processed in compliance with requirements. This included both Louisville Metro purchasing policies as well as contractual requirements.

The details of the scope and methodology of the review are addressed in the Observations and Recommendations section of this report. The audit would not identify all issues because it was based on a selective review of data.

## Opinion

It is our opinion that the internal control structure for Supplier Payment Thresholds needs improvement. The internal control rating is on page 6 of this report. This rating quantifies the opinion regarding the internal controls and identifies areas requiring corrective action. Opportunities to strengthen compliance were noted. Examples include the following.

- **Threshold Compliance.** The LeAP financial system does not monitor the \$10,000 aggregate limit, but does monitor the \$2,500 invoice limit. The aggregate limit must be manually reviewed prior to the initiation of a purchase.
  - One of the fifteen suppliers reviewed was identified as exceeding the \$10,000 aggregate limit on four payment transactions from multiple departments. It also appeared that several invoices had been split to avoid the \$2,500 invoice limit.
  - All of the transactions specifically reviewed for the \$2,500 invoice limit were determined to be in compliance with policy for the individual invoice threshold.
- **Contractual Compliance.** Several issues were noted concerning compliance with the purchase order documentation (e.g., contracts, grants, price quotes). Examples include the following.
  - *Purchase of Services.* One supplier was paid for services provided without a contract. Another supplier was paid for services that were rendered after the contract had expired.

- *Contract Pricing.* For two of fifteen suppliers there were payment transactions which were not in compliance with the contracted price for good / services.
- *Support Documentation.* For three of fifteen suppliers there were several payment transactions in which compliance with contractual terms for goods / services rendered could not be determined. While the activity appeared to be reasonable, a lack of adequate support documentation impaired the ability to verify compliance with contractual terms.

The implementation of the recommendations in this report will help improve the internal control structure and compliance with supplier payment thresholds.

### **Corrective Action Plan**

Representatives from the Office of Management and Budget have reviewed the results and are committed to addressing the issues noted. Corrective action plans are included in this report in the Observations and Recommendations section. We will continue to work with the Office of Management and Budget to ensure the actions taken are effective to address the issues noted.

Sincerely,

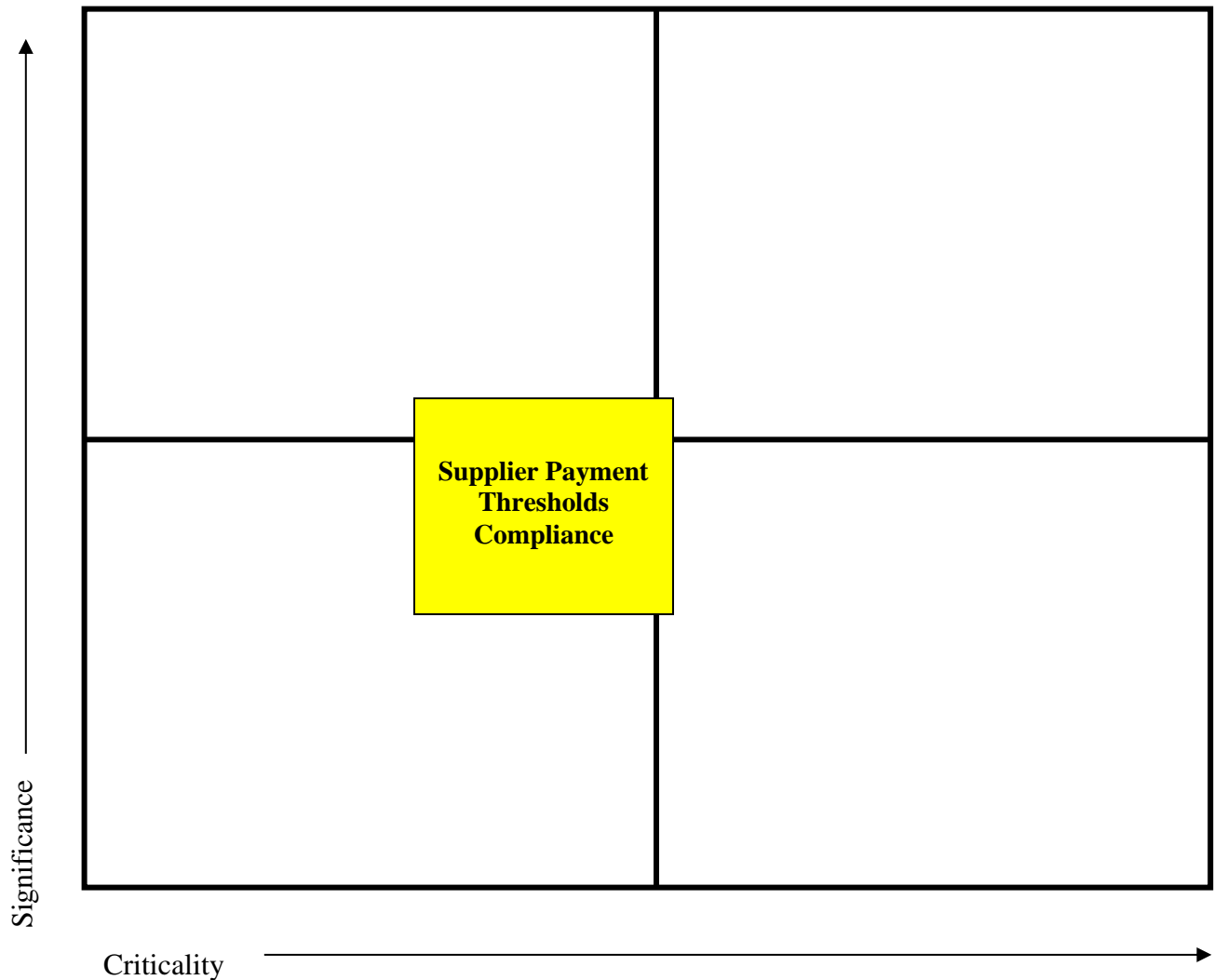


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Ingram Quick, CIA, CFE  
Chief Audit Executive

cc: Louisville Metro Council Government Accountability and Ethics Committee  
Director of Office of Management and Budget  
Louisville Metro External Auditors

**Internal Control Rating**



<u>Legend</u>			
<u>Criteria Issues</u>	<u>Satisfactory</u> Not likely to impact operations.	<u>Needs Improvement</u> Impact on operations likely contained.	<u>Inadequate</u> Impact on operations likely widespread or compounding.
<b>Controls</b>	Effective.	Opportunity exists to improve effectiveness.	Do not exist or are not reliable.
<b>Policy Compliance</b>	Non-compliance issues are minor.	Non-compliance issues may be systemic.	Non-compliance issues are pervasive, significant, or have severe consequences.
<b>Image</b>	No, or low, level of risk.	Potential for damage.	Severe risk of damage.
<b>Corrective Action</b>	May be necessary.	Prompt.	Immediate.



## **Background**

The purchasing policies of Louisville Metro Government are based upon the provisions of KRS 45A.343-460, KRS 45A.180-200 and KRS 67C.119 (6). The policies are designed to promote sound business principles and are intended to provide a system that ensures fairness and integrity. Individuals have specific responsibilities with regard to purchasing and have a duty to avoid conflicts of interest under the model procurement adopted by Metro Government. All persons making purchases on behalf of Louisville Metro Government are responsible for following the purchasing policy. Louisville Metro Government's purchasing policies and procedures are specific to expenditures for goods and services.

**Goods:** There are three primary methods of purchasing goods.

1. Non-contract purchases of \$2,500 or less may be purchased directly from the supplier of choice, provided that the aggregate amount of purchases from the supplier has not exceeded \$10,000 Metro-wide in the fiscal year. Less than \$2,500, the agency buys directly from vendor.
2. Non-contract purchases of more than \$2,500, not exceeding \$10,000 can be made using the Purchasing facilitated methods of Price Quote, provided that the aggregate amount of purchases from the supplier has not exceeded \$10,000 Metro-wide in the fiscal year, or Competitive Sealed Bid.
3. Purchases exceeding \$10,000 must be made using Competitive Sealed Bidding, Competitive Negotiation or Non-competitive Negotiation. In general, bidding should be used for purchases above \$10,000. However, procurement may be exempt from competitive bidding where use of Emergency Purchases, Sole Source or State Contracts procedures are followed and approved.
  - Certain procurements may be exempt from competitive bidding where it is not feasible or practical. A list of item descriptions meeting this definition is included in the Purchasing policies and procedures. The Office of Management and Budget Division of Purchasing maintains the right to modify the listing at its discretion.

**Services:** All purchases of services, regardless of dollar amount, must be made using a contract. There are three primary methods of purchasing services.

1. Purchases of licensed and non-licensed services, \$10,000 or less, are made by completing the Intent to Purchase Services (ITPS) contract procedures. If a more detailed contract is necessary, a Professional Services Contract (PSC) may be used.
2. Purchases of licensed and non-licensed services, in excess of \$10,000 are made using the PSC procedures.
3. Purchases using State price contracts.

Our review focused on compliance with threshold requirements, which included supplier payments above \$2,500 for fiscal year 2012. Supplier payments during this period totaled approximately \$261 million.

This was a scheduled audit.

## **Summary of Audit Results**

### **I. Current Audit Results**

See Observations and Recommendations section of this report.

### **II. Prior Audit Issues**

The Office of Internal Audit performed a review of Louisville Metro Government Vendor Payment Threshold Compliance in April 2005. Unless otherwise noted, all prior issues have been satisfactorily addressed.

### **III. Statement of Auditing Standards**

The audit was performed in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

### **IV. Statement of Internal Control**

An understanding of the internal control structure was obtained in order to support the final opinion.

### **V. Statement of Irregularities, Illegal Acts, and Other Noncompliance**

The review did not disclose any instances of irregularities, any indications of illegal acts, and nothing was detected during the review that would indicate evidence of such. Any significant instances of noncompliance with laws and regulations are reported in the Observations and Recommendations section of this report.

### **VI. Views of Responsible Officials / Action Plan**

A draft report was issued to the Office of Management and Budget on June 20, 2013. An exit conference was held at the Office of Management and Budget's Conference Room on July 8, 2013. Attending were Steve Rowland and Stephanie Moore representing Office of Management and Budget and Ingram Quick, Scott Shelton, and Patrick Crawford representing Internal Audit. Final audit results were discussed.

The views of the Office of Management and Budget officials were received on July 29, 2013 and are included as corrective action plans in the Observations and Recommendations section of the report. The plans indicate a commitment to addressing the issues noted.

LMCO §30.36(B) requires Louisville Metro Agencies to respond to draft audit reports in a timely manner. It specifically states that

*"The response must be forwarded to the Office of Internal Audit within 15 days of the exit conference, or no longer than 30 days of receipt of the draft report."*

The Office of Internal Audit extended the timeframe for response from OMB. The Office of Management and Budget's response was provided within the agreed upon timeframe.

## Observations and Recommendations

### Scope

A review of Louisville Metro Government's supplier payment thresholds was performed. The focus of the review was determining if the activity was in compliance with Louisville Metro's purchasing policies and procedures. This included verifying that supplier payment activity exceeding threshold limits was properly authorized by a contract. An understanding of Louisville Metro's purchasing policies and procedures was obtained through interview of key personnel and review of relevant documentation. This included how activity is processed, recorded and monitored. The objective was to obtain assurance that internal controls were effective in mitigating certain risks.

The review period covered accounts payable activity from fiscal year 2012 (July 2011 through June 2012). The population of supplier payment transactions was obtained from Louisville Metro's financial system (LeAP). Analysis was performed to determine the number of suppliers paid, amounts, and the number of transactions. Tests of sample data were performed to determine whether transactions were processed in compliance with requirements. This included both Louisville Metro purchasing policies as well as contractual requirements. The audit would not identify all issues because it was based on a selective review of data. Tests included the following.

- **\$10,000 Threshold:** Ten suppliers with aggregate payments exceeding \$10,000 were chosen and individual transactions reviewed. Each of the suppliers sampled had payment transactions from a single Metro department.

An additional five suppliers with aggregate payments exceeding \$10,000 were chosen and individual transactions reviewed. Each of these suppliers had payment transactions from multiple Metro departments.

- **\$2,500 Threshold:** Ten suppliers with individual invoices greater than \$2,500 but less than \$10,000 were chosen and all payment transactions reviewed.
- **Payment Authorizations:** For each of the twenty-five suppliers sampled in testing of payment thresholds, payment transactions were reviewed to determine if the goods/services purchased were in compliance with the purchase order documentation (e.g., contract, grant, price quote).

### Observations

Issues were noted with Louisville Metro Government's supplier payment activity. As a result, the internal control structure needs improvement to increase effectiveness in mitigating operational risks of the activity and improve compliance with applicable requirements. Opportunities to strengthen the controls are as follows.

#1) Threshold Compliance

#2) Contract Compliance

Details of these begin on the following page.

## **#1 - Threshold Compliance**

Issues were noted regarding compliance with supplier payment thresholds. Specifics include the following.

- **\$10,000 Aggregate Payments Threshold.** The payment activity for one of fifteen suppliers reviewed exceeded the \$10,000 aggregate limit. Four of thirteen purchase orders issued for payment to the supplier exceeded the aggregate limit and were not authorized by a contract, grant, bid quote, etc. Adherence to purchasing policies would require one of these types of purchasing methods to be used once the aggregate threshold was met.

It was also noted that three invoices from the supplier appear to have been split into seven invoices with hyphenated numbers, thereby avoiding policy requirements for individual invoices exceeding \$2,500. Further review of these invoices identified same day purchase of similar product, sequential purchase order numbers used for payment, and the invoices did not generally conform in appearance with other invoices from the same supplier that were not in question. This increases the risk of undermining procurement policies and procedures established to increase transparent and competitive procurement.

## **Recommendations**

Appropriate personnel should take corrective action to address the concerns noted. Specific recommendations include the following.

- ✓ OMB should develop well-designed policies and procedures to ensure that departments do not individually or cumulatively exceed supplier payment limits. These policies and procedures should be adequately designed to provide assurance that the process is well governed and that controls are effective and efficient.
- ✓ The aggregate amount of payments to a supplier for the fiscal year should be verified through the financial system to determine if a payment threshold will be exceeded, prior to the granting of approval for the purchase. This may be in the form of using existing financial system reports, or developing new reports, to use as monitoring tools. This level of monitoring should be performed on a consistent basis to avoid noncompliance with threshold requirements.
- ✓ All persons making purchases on behalf of Louisville Metro Government (LMG) are responsible for following the LMG Purchasing Policy. Requests to purchase goods and services should be made in advance of the procurement of the goods or services. Departmental personnel should submit a completed "Purchase Request" form to their Business Administrator, who will verify the request, available funding and provide approval. The Business Administrator should then work with departmental personnel to procure the goods or services needed in compliance with LMG's Purchasing Policy.



## **#2 - Contract Compliance**

Issues were noted regarding compliance with contractual agreements. The following issues were noted.

- **Purchase of Services.** For one of fifteen suppliers, services were purchased without the use of a contract. This occurred on two invoices totaling \$587. Section IIB of Louisville Metro Purchasing Policy states “in order to ensure that all insurance requirements are satisfied, all purchases of services, regardless of dollar amount, must be made using a contract.”
- **Payment Authorization.** For one of fifteen suppliers, not all services provided were covered by an effective contract. A Professional Services Contract (PSC) that expired was used to pay for services rendered. An extension of the contract could not be located in the supplier’s purchasing file. Payments after the expiration of the contract totaled \$9,266.
- **Contract Pricing.** There were payment transactions which were not in compliance with the contracted price for goods / services. Examples include the following.
  - For one of fifteen suppliers, the amount paid as through revenue share was not calculated correctly based on the distribution of net revenue outlined in the lease agreement. An outdated payment calculation formula resulted in an overpayment to the supplier of \$3,414.
  - For one of fifteen suppliers, the goods/services unit pricing on the invoice did not agree with the contracted unit pricing. The unit price on the contract was \$0.825 while the unit price charged on the invoice was \$0.83. This resulted in an overpayment to the supplier of \$232.
- **Support Documentation.** There were several payment transactions in which compliance with contractual terms for goods provided or services rendered could not be determined. While the activity appeared to be reasonable, a lack of adequate support documentation impaired the ability to verify compliance with contractual terms. Examples include the following.
  - For one of fifteen suppliers, the amount charged for labor could not be verified to the contractual rate as the invoice did not specify the number of hours worked. This occurred on two invoices with labor charges totaling \$995.
  - For one of fifteen suppliers, mileage and fuel charges for rental equipment were incurred that were not specified in the contract, including one instance in which both mileage and fuel were charged. Although the contract indicated certain types of equipment would be charged for mileage (i.e., a dump truck), there was not a mileage rate specified for each particular type of equipment rented. This occurred on six invoices with mileage and fuel charges totaling \$448.
  - For one of fifteen suppliers, a negotiated material charge was incurred that was not substantiated through a scope of work. Although the contract stated a scope of work detailing task and material pricing would be provided, documentation was not included in the supplier’s purchasing file nor was there any documentation supporting the invoice. This occurred on one invoice with material charges totaling \$59.

### **Recommendations**

Appropriate personnel should take corrective action to address the concerns noted. Specific recommendations include the following.

- ✓ With the centralization of departmental business operations, the Office of Management and Budget (OMB) provides oversight of the procurement process to Business Administrators and departmental personnel. Additional training to clearly define roles and responsibilities may be necessary to assist in providing assurance payments are made in accordance with contractual terms and conditions.
- ✓ OMB and appropriate departmental personnel should adhere to a more consistent and standardized monitoring process to reduce the risk of Louisville Metro Government funds being spent inappropriately or ineffectively. OMB should develop an effective process to monitor contract activity in order to mitigate risks associated with contracting out goods and services. This process should include steps to ensure payments are processed in accordance with Louisville Metro Government policies and adhere to provisions within the contract.
- ✓ Personnel responsible for approving payments should ensure applicable requirements / terms have been adhered to. This includes price, discounts and performance guarantees and should be able to be accomplished solely by review of the actual contract. In some instances additional supporting documentation may be necessary to support payment of the invoice. Payments should adhere to the related contractual documentation to help ensure legal expenditure limitations are followed and economic benefits may be obtained (e.g., financial incentive payment terms, discounts).
- ✓ Appropriate personnel should review all documentation supporting the invoice to ensure compliance with contractual terms prior to the approval of payment. The documentation should be explicit as to the services / work performed or goods provided. Sufficient documentation should be provided to allow a reasonable person to independently verify the expenditure agrees to the contractual terms. This should be able to be accomplished solely by reviewing the supporting documents; it should not require additional information from the department.
- ✓ Any negotiations agreed upon by parties subsequent to the contract being awarded should be thoroughly documented and provided to the Purchasing Division of the Office of Management and Budget. Purchasing serves as the custodian for Louisville Metro contracts and therefore their files should contain adequate support documentation to record the purpose and authorization of all purchase orders.

## **Office of Management and Budget's Corrective Action Plan**

### **#1 – Threshold Compliance**

Louisville Metro Government has designed a procurement policy that conforms to the provisions of KRS 45A.343-4600, KRS 45A.180-200 and KRS 67C-119 (6). The policy includes information on required thresholds and states that it is the responsibility of the department that is making the purchase to ensure the threshold limits are met. OMB, through its Business Operations division, assists departments in meeting these requirements. The process for checking supplier threshold has been communicated to all staff in the Business Operations division. Supplier threshold should be verified using the amount encumbered for each vendor for a fiscal year prior to entering a purchase order or release. OMB will review the process and provide detailed instructions to all individuals involved in assisting departments in the procurement process in order to ensure the process is followed.

OMB recently underwent an internal review and an area of focus was the procurement process. A standardized government-wide purchase order process is under evaluation and will be reviewed for implementation over the next several months.

### **#2 – Contract Compliance**

The items addressed regarding contract compliance are being addressed by OMB. Contract compliance is an area of high importance as we ensure we are paying vendors appropriately. Our investigation into the finding showed that there is a security issue in LeAP that permits funds to be encumbered after the contract expiration date in LeAP. The issue was brought to Oracle's attention as a functionality issue. Oracle has stated that this is intended functionality of the system as items may be shipped after a contract expiration date. OMB is working to determine if we will develop a work around to this issue in order to prohibit this issue from occurring again.

Two issues were identified related to contract pricing and both issues have been addressed. Both findings indicated that overpayments may have been made to vendors. Procedures for reviewing invoices and ensuring the invoice detail is adequate to compare against the contract have been documented and distributed to all staff involved in processing invoices for payment. Additional training will be provided to staff in reviewing all documentation provided by the vendor to ensure Metro is receiving adequate detail to compare invoiced charges against the contract that items charged are included on the contract, and all charges are accurate. In the first instance identified, we reviewed the contract and payments and determined that an overpayment had been made. We have since contacted the vendor to request a refund of the overpaid amount.

In reviewing the other finding it was noted that a contract amendment increasing the price from \$0.0825 per unit to \$0.083 per unit was completed and signed by both the agency and the vendor, however this was not submitted to Purchasing for approval and included with the contract in LeAP. This issue has been addressed with the Department and training on the process has been given to staff involved in departmental contracts.

Office of Internal Audit

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